



## I. INTRODUCTION

This re-hearing is before the Public Service Commission of South Carolina (“Commission”) upon a remittitur from the South Carolina Supreme Court (“Supreme Court”).

This matter is before the Commission on the Application (“Application”) of Daufuskie Island Utility Company, Incorporated (“DIUC” or “the Company”) filed on June 9, 2015, seeking approval of a new schedule of rates and charges for water and sewer service that DIUC provides to its customers within its authorized service area in South Carolina. The Application was filed pursuant to S.C. Code Ann. Section 58-5-240 and 10 S.C. Code Ann. Regs. 103-712.4.A and 103.512.4.A.

In the Application, DIUC requested to increase revenues for combined operations by \$1,182,301, consisting of a water revenue increase of \$590,454 and a sewer revenue increase of \$591,847. The revenue increase utilizes a return on equity (“ROE”) of 10.5% based on the rate of return on rate base methodology and a 2014 historical test year. Tariff changes to bring the rates between the Haig Point and Melrose communities to uniformity were also requested.

DIUC’s last rate case before this Commission was in Docket No. 2011-229-WS. In that case, Commission Order No. 2012-515 approved a Settlement Agreement entered into by the Haig Point Club and Community Association, Inc. (“HPCCA”); Melrose Property Owner’s Association, Inc. (“MPOA”); Bloody Point Property Owner’s Association (“BPPOA”) (collectively the “POAs”); and DIUC that was not objected to by the South Carolina Office of Regulatory Staff (“ORS”); whereby DIUC received a revenue increase of \$291,485 based on a \$5,000,000 rate base; an operating margin of 16.64%; and an ROE of 8.81%. DIUC also agreed not to seek another rate adjustment prior to July 1, 2014.

DIUC's South Carolina operations are classified by the National Association of Regulatory Utility Commissioners ("NARUC") as a Class B water and wastewater utility according to water and sewer revenues reported on its application for the test year ending December 31, 2014. The Commission approved service area for DIUC is on Daufuskie Island located in Beaufort County, South Carolina.

The Commission's Docketing Department instructed DIUC to publish a prepared Notice of Filing, one time, in newspapers of general circulation in the area affected by DIUC's Application. The Notice of Filing described the nature of the Application and advised all interested persons desiring to participate in the scheduled proceedings of the manner and time in which to file appropriate pleadings for inclusion in the proceedings as a party of record. The Commission also instructed DIUC to notify each affected customer by mailing or, where the customer had previously agreed to electronic notice, by e-mailing each customer a copy of the Notice of Filing. DIUC filed Affidavits of Publication and Mailing demonstrating that the Notice of Filing had been duly published and provided to all customers.

Petitions to Intervene were filed on behalf of the POAs on July 23, 2015 and Beach Field Properties, LLC ("Beach Field") on July 27, 2015.

Subsequent to their intervention, the POAs requested the Commission to schedule a public night hearing at a convenient time and location for customers of DIUC to present their comments regarding the service and rates of DIUC. In response, the Commission held a public night hearing pursuant to Order No. 2015-586. Under this Order, a public hearing was set and noticed by the Commission, and the Company provided an affidavit certifying that it had provided notice of the date, time and location of the local public hearing via publication in the Beaufort Gazette and The

Island Packet. On September 15, 2015, the Commission held a night hearing beginning at 6:00 pm at the Haig Point Club Clubhouse, 130 Clubhouse Lane, Daufuskie Island, South Carolina.<sup>1</sup>

On October 28, 2015 the Commission, with Chairman Nikiya "Nikki" Hall presiding, heard the matter of DIUC's Application beginning at 10:30 am at the Commission Hearing Room located at 101 Executive Center Drive in Columbia, South Carolina.

DIUC was represented by G. Trenholm Walker, Esquire and Thomas P. Gressette, Jr., Esquire. The POAs were represented by John J. Pringle, Jr., Esquire, John F. Beach, Esquire and Lyndey Ritz Zwing, Esquire. Beach Field was represented by M. John Bowen, Jr., Esquire and Margaret M. Fox, Esquire. ORS was represented by Shannon Bowyer Hudson, Esquire and Andrew M. Bateman, Esquire.

At the October 28, 2015 hearing, a Settlement Agreement between the POAs and ORS was entered into the record after an objection to it by DIUC was overruled. DIUC, the POAs and ORS presented testimony and exhibits after one public witness, Mr. Reid Delaney,<sup>2</sup> testified. Mr. Delaney testified that he owns property on which assets are located and utilized by DIUC for its regulated water and sewer business.

DIUC presented the testimony of: John F. Guastella<sup>3</sup> (direct and rebuttal testimony), President of Guastella Associates, LLC ("GA"), a utility management, valuation and rate consulting firm headquartered in Boston, Massachusetts; Gary C. White (direct), Vice President and Director of Accounting at GA; Eric Johanson (direct), DIUC Chief Operator; and the

---

<sup>1</sup> Hearing Exhibit 1 consists of the night hearing sign-in sheets and Hearing Exhibit 2 consists of comments filed by public witness Andy Mason.

<sup>2</sup> Hearing Exhibit 4 is a survey provided by Mr. Delaney.

<sup>3</sup> Hearing Exhibit 7 consists of Guastella Direct Exhibits A and B. Hearing Exhibit 8 consists of Guastella Rebuttal Exhibits 1 through 5. Hearing Exhibit 9 is the GA Management Agreement. Hearing Exhibit 10 consists of the ORS and POAs responses to DIUC's discovery requests.

Honorable Maria Walls<sup>4</sup> (rebuttal), Beaufort County Treasurer. Mr. Guastella and Mr. White testified as a panel about the management and finances of DIUC. Mr. Johanson's testimony addressed the operations of DIUC. Mr. Johanson was excused from the hearing without appearing before the Commission after his testimony was accepted into the record without objection from the other parties. Ms. Walls provided testimony on property taxes.

The POAs presented two panels of witnesses. The first panel consisted of Paul Vogel<sup>5</sup> (direct), Haig Point Club and Community Association resident; Doug Egly<sup>6</sup> (direct), Chief Operating Officer of the Haig Point Association; and Tony Simonelli (direct), real estate broker on Daufuskie Island. The second panel consisted of Lynn M. Lanier<sup>7</sup> (direct) and Charles Loy<sup>8</sup> (direct and surrebuttal), Principals of GDS Associates, Inc., a utility consulting and engineering firm with its principal offices in Marietta, Georgia; and Harry Jue<sup>9</sup> (direct), water and sewer consultant with Hussey Gay Bell Engineering. POA witnesses Vogel, Egly, and Simonelli presented testimony illustrating the points of view of their respective organizations, and each providing various facts and opinions opposing DIUC's request. POA witness Loy provided expert testimony regarding accounting and rate base issues. POA witness Lanier provided expert testimony on the overall Application and incorporated Mr. Loy's recommended adjustments. Beach Field did not pre-file or present testimony or cross examine any witness at the Commission hearing.

ORS presented the testimony of Douglas H. Carlisle<sup>10</sup> (direct), ORS Economist; Ivana C.

---

<sup>4</sup> Hearing Exhibit 5 consists of Walls Rebuttal Exhibit A.

<sup>5</sup> Hearing Exhibit 11 is Vogel Exhibit 1.

<sup>6</sup> Hearing Exhibit 12 is Egly Exhibit 1.

<sup>7</sup> Hearing Exhibit 14 consists of Lanier Exhibits 1 through 5. Exhibit 3 was revised at the hearing.

<sup>8</sup> Hearing Exhibit 15 is Loy Surrebuttal Exhibit 1. Hearing Exhibit 16 is Loy Direct Appendix A.

<sup>9</sup> Hearing Exhibit 13 is Jue Exhibit 1.

<sup>10</sup> Hearing Exhibit 17 is Carlisle Direct Exhibits 1 through 10.

Gearheart<sup>11</sup> (direct), ORS Audit Manager; and Willie J. Morgan<sup>12</sup> (direct and surrebuttal), ORS Deputy Director for the Water and Wastewater Department. Dr. Carlisle's testimony included an analysis and recommendation for an ROE. Ms. Gearheart's direct testimony described ORS's examinations of the application and DIUC's books and records as well as the subsequent accounting and pro forma adjustments recommended by ORS. Mr. Morgan's direct testimony focused on DIUC's compliance with Commission rules and regulations, ORS's business audit of DIUC's water and wastewater systems, test-year and proposed revenue, and performance bond requirements.

On December 8, 2015, this Commission issued an Order approving the Settlement between the POAs and ORS and accepting the adjustments to rates laid out therein.

On December 21, 2015, counsel for DIUC filed a Petition for Reconsideration and/or Rehearing with the Commission. According to the Petition for Reconsideration and/or Rehearing, if DIUC were forced to implement the rates as established by the Settlement Agreement, it would default on its obligations and its ability to provide service would be threatened.

On January 20, 2016, DIUC filed a Petition for Bond Approval in which it notified the Commission that, pursuant to S.C. Code Ann. § 58-5-240, DIUC intended to put its originally requested rates into effect under bond during the pendency of its appeals.<sup>13</sup>

On February 25, 2016, the Commission issued an Order denying DIUC's Petition for Reconsideration and/or Rehearing. In that Order, the Commission stated that the evidence

---

<sup>11</sup> Hearing Exhibit 18 is Gearheart Direct Exhibits 1 through 8.

<sup>12</sup> Hearing Exhibit 19 is Morgan Direct Exhibits 1 through 8. Hearing Exhibit 20 is Morgan Surrebuttal Exhibits 1 and 2.

<sup>13</sup> While the Commission Order denying DIUC's Petition for Reconsideration and/or Rehearing was not issued until February 25, 2016, the Commission issued a Directive denying DIUC's Petition for Reconsideration and/or Rehearing on January 13, 2016.

presented by ORS in the original hearing was competent and credible. Additionally, the only adjustment put forth to the Commission as part of the Settlement Agreement that was not an ORS adjustment was DIUC's original bad debt adjustment, for which DIUC provided support in its Application.

On March 1, 2016, the Commission approved the proposed surety and bond in the amount of \$787,867, effective July 1, 2016, for a period of one year.<sup>14</sup>

On March 22, 2016, DIUC filed a Notice of Appeal with the Supreme Court in which DIUC appealed the Decision and Order of the Commission that Approved the Settlement Agreement between the ORS and POAs.

On December 14, 2016, the Supreme Court held oral arguments between the Appellant, DIUC, and the Respondents, ORS and the POAs. On July 26, 2017, the Supreme Court issued its Order, reversing the Commission's order and remanding the matter back to the Commission for a *de novo* hearing. In its opinion, the Supreme Court held that the Commission erred in approving and adopting the Settlement Agreement, and that DIUC is entitled to a new hearing in which the parties may present additional evidence. In addition, the Supreme Court gave guidance to the Commission on three matters: inclusion of the Elevated Tank Site in rate base, property tax expense, bad debt expense.<sup>15</sup>

On August 11, 2017, the Supreme Court issued a remittitur, thereby remitting the matter back to the Commission.

---

<sup>14</sup> Due to the length of the Appellate and remand process, a Joint Request was filed on June 15, 2017, by DIUC and the POAs that sought to extend DIUC's surety bond by an additional six months. This Commission issued an Order on June 30, 2017, approving the joint request.

<sup>15</sup> Despite the fact that this case was remanded to the Commission for a *de novo* hearing, the parties that participated in the re-hearing primarily confined their testimony previously unresolved issues and issues brought about by newly introduced evidence. Therefore, much of this Order's discussion on issues not litigated at the re-hearing remains unchanged from the previous Commission Order.

On August 24, 2017, DIUC filed a Motion for Costs with the Supreme Court in which it sought attorney's fees and costs against Respondents in the amount of \$60,382.37.<sup>16</sup>

On November 15, 2017, the Supreme Court issued an Order on DIUC's Motion for Costs granting DIUC the amount of \$6,656.37 to be recovered against ORS, Haig Point Club and Community Association, Inc., Bloody Point Property Owner's Association, and Beach Field Properties, LLC. These costs were directed by the Supreme Court to be added to the remittitur. The Supreme Court's Order denied the \$56,726 amount for bond premiums that DIUC sought.

On December 6 and 7, 2017, the Commission, with Chairman Swain E. Whitfield presiding, heard the re-hearing on the matter of DIUC's Application beginning at 10:30 am at the Commission Hearing Room located at 101 Executive Center Drive in Columbia, South Carolina.

At the re-hearing, DIUC was represented by G. Trenholm Walker, Esquire and Thomas P. Gressette, Jr., Esquire. The POAs were represented by John J. Pringle, Jr., Esquire and John F. Beach, Esquire. Beach Field did not participate in the re-hearing. ORS was represented by Jeffrey M. Nelson, Esquire and Andrew M. Bateman, Esquire.

At the re-hearing, DIUC presented the testimony of: John F. Guastella<sup>17</sup> (re-hearing direct and re-hearing rebuttal testimony) and Gary C. White<sup>18</sup> (re-hearing direct and re-hearing rebuttal). Mr. Guastella and Mr. White testified as a panel about the management and finances of DIUC.

The POAs also presented its two witnesses as a panel. The panel consisted of Lynn M. Lanier<sup>19</sup> (re-hearing direct and re-hearing surrebuttal) and Charles Loy<sup>20</sup> (re-hearing direct and re-

---

<sup>16</sup> Of the \$60,382.37, \$53,726 is attributable to bond premiums for bonds obtained pursuant to S.C. Code Ann. § 58-5-240(D), while the remaining, \$6,656.37 is attributable to Court fees, copy fees, and capped attorney's fees.

<sup>17</sup> Re-hearing Exhibit 1 consists of Guastella Direct and Rebuttal Exhibits.

<sup>18</sup> Re-hearing Exhibit 3 consists of White Direct and Rebuttal Exhibits.

<sup>19</sup> Re-hearing Exhibit 6 consists of Lanier Exhibits 1 through 7 corresponding to his re-hearing direct testimony. Re-hearing exhibit 7 consists of Lanier Exhibits Exhibit LML-8, corresponding to his re-hearing surrebuttal testimony.

<sup>20</sup> Re-hearing Exhibit 5 is Loy re-hearing direct Exhibits 1 through 6.



hearing surrebuttal), Principals of GDS Associates, Inc., a utility consulting and engineering firm with its principal offices in Marietta, Georgia. POA witness Loy provided expert testimony regarding accounting and rate base issues. POA witness Lanier provided expert testimony on the overall Application and incorporated Mr. Loy's recommended adjustments.<sup>21</sup>

ORS presented the testimony of Douglas H. Carlisle (re-hearing direct), ORS Economist; Daniel F. Sullivan<sup>22</sup> (re-hearing direct and re-hearing surrebuttal), ORS Deputy Director of Auditing; and Dawn M. Hipp<sup>23</sup> (re-hearing direct and re-hearing surrebuttal), ORS Director for the Utility Rates and Services Department. Dr. Carlisle's testimony adopted and re-affirmed the positions taken in his direct testimony and exhibits, which were filed on October 2, 2015, and his oral testimony given to the Commission on October 28, 2015. Mr. Sullivan's re-hearing direct testimony adopted the previously filed testimony of ORS witness Ivana C. Gearheart. Additionally, Mr. Sullivan's testimony described ORS's examinations of the re-hearing testimony and exhibits filed by DIUC in conjunction with the guidance provided by the Supreme Court in its Opinion No. 27729 and any accounting and pro forma adjustments recommended by ORS resulting therefrom. Ms. Hipp's re-hearing direct testimony adopted the direct testimony and exhibits of ORS witness Willie J. Morgan, and re-affirmed the positions taken by ORS witness Morgan during the hearing, with the exception of any changes made to comply with the guidance given by the Supreme Court. Additionally, Ms. Hipp presented ORS's findings and recommendations related to ORS's review of the re-hearing testimony and exhibits filed by John Guastella and Gary White on behalf of DIUC and applicable discovery related to DIUC's rate case

---

<sup>21</sup> At the hearing, the Commission overruled a DIUC objection to the introduction of the POAs witnesses' testimonies and exhibits.

<sup>22</sup> Re-hearing Exhibit 8 is Sullivan re-hearing Direct Exhibits 1 through 9.

<sup>23</sup> Re-hearing Exhibit 9 is Hipp re-hearing Direct Exhibits 1 through 5. Re-hearing Exhibit 10 is Hipp Surrebuttal Exhibit 1.

invoices, management fees, and requested deferral of \$155,328. Ms. Hipp's re-hearing surrebuttal testimony responded to DIUC witness John Guastella's rebuttal testimony. Specifically, Ms. Hipp addressed ORS's recommendation to remove certain rate case expenses, a 5 year amortization period for recovery of rate case expenses, ORS's analysis of management fees, and DIUC's assertions regarding Guastella and Associates help to assure the financial stability of DIUC.

## **II. REVIEW OF THE EVIDENCE AND EVIDENTIARY CONCLUSIONS**

### **Standards and Required Findings**

DIUC's Application was filed pursuant to S.C. Code Ann. Sections 58-5-210 and 58-5-240 and 10 S.C. Code Ann. Regs. 103-712.4.A and 103.512.4.A. In considering the Application, the Commission must ascertain and fix just and reasonable rates, standards, classifications, regulations, practices, and measurements of service to be furnished. Thus, the Commission must give due consideration to the Company's total revenue requirements and review the operating revenues and operating expenses of DIUC to establish adequate and reasonable levels of revenues and expenses. The Commission will consider a fair rate of return for DIUC based on the record and any increase must be just and reasonable and free of undue discrimination. DIUC has also asked this Commission to establish revenues based on an authorized ROE which is established to allow DIUC the opportunity to earn a fair return.

After discussion of the positions of the parties, the Commission reaches the legal and factual conclusions below based on its review of the facts and evidence of record.

The evidence supporting the Company's business and legal status is contained in the Application filed by DIUC, testimony, and in prior Commission Orders in the docket files of the Commission, of which the Commission takes judicial notice. This finding of fact is informational,

procedural and jurisdictional in nature, and the matters which it involves are not contested by any party.

Test Year<sup>24</sup>

With respect to the test year, DIUC utilized a historic test year – the twelve months ending December 31, 2014 with adjustments for 2015 expectations. ORS used the 2014 historical test year for two reasons: 1) because it was chosen by DIUC and 2) the underlying transactions in the 2014 books could be tested to ensure that the transactions were adequately supported, had a stated business purpose, were allowable for ratemaking purposes, and were properly recorded. Consistent with past practice and in accordance with generally accepted regulatory principles and prior Commission orders, ORS adjusted, as necessary, the revenues, expenditures, and capital investments to normalize the Company's operating experience and rate base. The POAs also utilized a 2014 historic test year with adjustments.

A fundamental principle of the ratemaking process is the establishment of a historical test year as the basis for calculating a utility's operating margin or, in this case, a return on rate base, and, consequently, the validity of the utility's requested rate increase. In order to determine what a utility's expense and revenues are for purposes of determining the reasonableness of a rate, one must select a 'test year' for the measurement of the expenses and revenues. *Heater of Seabrook v. Public Service Commission of South Carolina*, 324 S.C. 56, 478 S.E.2d 826, 828 n.1 (1996). While the Commission considers a utility's proposed rate increase based upon occurrences within the test year, the Commission will also consider adjustments for any known and measurable

---

<sup>24</sup>At the re-hearing, the Test Year was not actively litigated. As a result, the evidence relied upon in this section was primarily obtained during the October 28, 2015, hearing.

out-of-test year changes in expenses, revenues, and investments, and will also consider adjustments for any unusual situations which occurred in the test year. Where an unusual situation exists which shows that the test year figures are atypical, the Commission should adjust the test year data. *See Southern Bell v. The Public Service Commission*, 270 S.C. 590, 244 S.E. 2d 278 (1978); *see also, Parker V. South Carolina Public Service Commission*, 280 S.C. 310, 313 S.E.2d 290 (1984), *citing City of Pittsburgh v. Pennsylvania Public Utility Commission*, 187 P.A. Super. 341, 144 A.2d 648 (1958); *Southern Bell v. The Public Service Commission*, 270 S.C. 590, 244 S.E.2d 278 (1978). Based on the information available to the Commission and that all parties agreed to a 2014 test year, the Commission is of the opinion, and therefore concludes, that the test year ending December 31, 2014 is appropriate for the purposes of this rate request.

Rate of Return on Rate Base<sup>25</sup>

DIUC requested that its rates be determined in accordance with the rate of return on rate base methodology. The determination of rate of return on rate base requires three components: 1) capital structure; 2) cost of debt; and 3) cost of equity (or return on equity). However, by statutory requirement, the Commission must also specify an allowable operating margin in all water and wastewater orders. Although the Commission must specify an operating margin in its order, this does not mean that the operating margin methodology must be used in determining a fair rate of return. *Heater of Seabrook* at p. 64 and 830. Operating margin “is less appropriate for utilities that have large rate bases and need to earn a rate of return sufficient to obtain the necessary equity and debt capital that a larger utility needs for sound operation.” *Id.* No party actively contested

---

<sup>25</sup>At the re-hearing, the Rate of Return on Rate Base was not actively litigated. As a result, the evidence relied upon in this section was primarily obtained during the October 28, 2015, hearing.

the use of the rate of return on rate base methodology and given DIUC's large rate base, the Commission finds the rate of return on rate base methodology appropriate in this case.

Capital Structure and Cost of Debt<sup>26</sup>

With respect to the capital structure, DIUC recommended a pro forma capital structure of 41.2% debt and 58.8% equity. During the October 28, 2015, hearing ORS witness Dr. Carlisle testified there are two concerns with the method DIUC used to calculate its capital structure: 1) DIUC included pro-forma long-term debt in its long-term debt calculation; and 2) DIUC proposed an inflated equity amount. (October 28, 2015, Hearing Tr. p. 472, ll. 17-20). Dr. Carlisle noted that both result in an increase in the ROE. (Id.) The pro forma debt is based on the cost of debt DIUC expects, and as Dr. Carlisle noted, the outcome of DIUC's negotiations with banks or lenders is unknown at this time; therefore, DIUC's pro forma debt should not be included. (October 28, 2015, Hearing Tr. p. 473). The POAs also agreed that debt should not include future amounts. (October 28, 2015, Hearing Tr. p. 436, ll. 8-14). Dr. Carlisle further testified that DIUC's capital structure is weighted more heavily with equity, which is more expensive than debt. (Id.) In contrast to a projected or pro forma capital structure, ORS recommended a hypothetical capital structure of 46% long-term debt and 54% equity calculated by averaging the known capital structure used by water companies in the United States with publicly traded stock. (Id.) The POAs produced an adjusted capital structure of 57.55% debt and 42.45% equity (Hearing Exhibit 14, Amended Lanier Exhibit 3), based on a downward adjusted rate base, which is discussed later in this Order.

---

<sup>26</sup>At the re-hearing, the Capital Structure and Cost of Debt was not actively litigated. As a result, the evidence relied upon in this section was primarily obtained during the October 28, 2015, hearing.

As to the specific cost of debt rate, during the original hearing DIUC recommended 6.20%. The POAs testified that 6.20% is relatively high in the current interest rate environment, but is probably a reasonable rate given DIUC's precarious financial state. To calculate the 6.20% debt rate, DIUC included anticipated legal and GA fees in the financing fees. In support of the debt amount, Mr. Guastella testified the debt he used is based on his knowledge of prior financing costs applied to the costs expected to be incurred for future refinancing. As a percentage of the total debt, the anticipated fees are 13.56% per ORS's calculations. ORS did not incorporate the additional fees into the debt rate because the fees are a large percentage of the total debt and did not originate from a lending institution. ORS recommended that the actual debt rate being paid by DIUC to the current lending institution, 5.29%, be used.

At the re-hearing, Dr. Carlisle reaffirmed his previously recommended capital structure of 46% long-term debt and 54% equity. (Rehearing Tr. p. 433, ll. 1-2).

Upon consideration of evidence, the Commission adopts the capital structure, 46% long-term debt and 54% equity, and debt rate, 5.29%, recommended by ORS since they are based on known data instead of expected events. The Commission declines to use the POAs capital structure because it is based on a downward adjusted rate base (discussed in the Rate Base section below) that this Commission declines to use.

#### Cost of Equity/Return on Equity<sup>27</sup>

At the October 28, 2015, hearing, DIUC witness Guastella testified that the requested 10.5% ROE is based on his experience and judgment. The POAs witness Lanier testified, "This

---

<sup>27</sup> At the re-hearing, the Cost of Equity/Return on Equity was not actively litigated. As a result, the evidence relied upon in this section was primarily obtained during the October 28, 2015, hearing.

is the same rate the Company requested in its 2012 rate case<sup>28</sup>, which was a specified rate, rather than a rate developed through justification of the ROE required to meet its needs for profit margin and to attract the needed debt capital.” (October 28, 2015, Hearing Tr. p. 437, ll. 1-4). In contrast to DIUC, ORS’s Dr. Carlisle recommended an ROE of 9.31% based on a range of 8.91% to 9.71% using results from the Discounted Cash Flow model (“DCF”), Capital Asset Pricing Method (“CAPM”) and the Comparable Earnings Model (“CEM”). (October 28, 2015, Hearing Tr. p. 471 and 474). Dr. Carlisle testified the DCF and CAPM are known and generally accepted methods for determining a recommended ROE. (Id.) The POAs testified that the DCF is the prevailing method used for determining appropriate ROEs. The POAs also testified that while the DCF and CAPM are recognized as methods for calculating ROEs, the DCF and CAPM provide challenges since there are not many publicly traded companies similar to DIUC. For his analyses, Dr. Carlisle examined data on companies with publicly traded stock of which more data is available, because DIUC requested rates based on rate of return. (October 28, 2015, Hearing Tr. p. 475). Companies with publicly traded stock yield more data than what is available for privately held companies. (Id.) Specifically, Dr. Carlisle testified that he used publicly traded companies classified as “water utilities” by Value Line or *Yahoo! Finance* for his DCF and CAPM since they are in the same line of business as DIUC and share similar risks. (Id.) For his CEM analysis, Dr. Carlisle used companies with comparable betas to those of the companies used in his DCF and CAPM group. (Id.)

DIUC did not provide analyses similar to those used by Dr. Carlisle; however, Schedule A-3 of DIUC’s application shows the following references to ROE:

Connecticut DPUC Formula:	
Average Large Company	9.69%

---

<sup>28</sup>The merits hearing for DIUC’s last rate case in Docket No. 2011-229-WS was held in 2012.

Small Company Adder	0.50%
Performance Adder	<u>0.50%</u>
	<u>10.69%</u>

Florida PSC Leverage Graph Formula:

$5.6\% + (2.279 / \text{Equity Ratio})$	= ROE
Range	100% = 7.88%
	40% = 11.30%
Equity Ratio	58.8% = <u>9.47%</u>

There is no discussion of these components in Schedule A-3 or testimony, with the exception of Mr. Guastella's rebuttal testimony containing the following single sentence, "Under the Connecticut Public Utilities Regulatory Authority formula for return on equity for small companies, the rate of return on equity for DIUC is 10.69%." ORS provided no testimony on either the Connecticut or Florida ROE formulas. The POAs could find no other reference to the Connecticut formula and challenged DIUC's portrayal of the Florida formula. Witness Lanier for the POAs testified, "[S]imply including a formula on a schedule and a calculated number is not sufficient rationale to support a ROE, particularly of 10.5%, when the company is requesting a revenue increase of over 100% in order to achieve such return." (October 28, 2015, Hearing Tr. p. 439, ll. 7-9). The POAs acknowledged Dr. Carlisle as a source to support an appropriate ROE, and the POAs pre-filed direct testimony recommended an ROE in the range of 8.5% to 9.0% in consideration of a lower rate base and based on various examples of DIUC's "irresponsibility in its operations since the rate increase authorized in 2012 and in the use of debt funds, in view of the critical need for cash." (October 28, 2015, Hearing Tr. p. 441, ll. 2-3).

In summary, at the October 28, 2015 hearing, DIUC requested an ROE of 10.5%; ORS recommended an ROE of 9.31% based on a range of 8.91% to 9.71%; and the POAs recommended an ROE in the range of 8.5% to 9.0%.



At the re-hearing, Dr. Carlisle reaffirmed his previously recommended ROE range of 8.91% to 9.71%. (Rehearing Tr. p. 433, l. 2).

Upon consideration of the various witnesses, the Commission adopts the range set forth in evidence as produced by ORS. ORS used the well-known and commonly-accepted DCF method, CAPM, and CEM for developing its range of 8.91% to 9.71%. Those methods, as applied by ORS, are grounded in sound analysis. While the POAs also used the well-known analyses, this Commission declines the range proposed by the POAs. The Commission finds DIUC's ROE recommendation lacking in support and analysis.

#### Rate Base

At the October 28, 2015 hearing, the rate base proposed by DIUC for combined operations was \$7,085,475.<sup>29</sup> In support of its rate base, DIUC included several plant assets, particularly a 125,000 gallon elevated water storage tank, well and facilities (the "facilities") which are located on real property not owned by DIUC. Specifically, the facilities are located on real property (the "Site") that, as described below, was sold at a delinquent tax sale. DIUC does not dispute that it is not the owner of the Site. However, DIUC offered testimony and evidence that it owns these facilities, namely that 1) the tax sale did not include the storage tank, well and facilities, only the Site; 2) DIUC pays property taxes to Beaufort County for the facilities; 3) DIUC has the right to operate those facilities on any parcel of land in the Haig Point development; and 4) these facilities are "used and useful" in providing water service. (October 28, 2015, Hearing Tr. p. 195 and pp. 82-83). DIUC offered the testimony of the Beaufort County Treasurer who stated the Company is paying a utility tax on water system infrastructure. (October 28, 2015, Hearing Tr. p. 83).

---

<sup>29</sup> See Application Schedule A-4; however the December 31, 2014 rate base total from Application Schedules W-B and S-B totals \$6,914,024.

At the October 28, 2015 hearing, both ORS and the POAs excluded the facilities from rate base. ORS testified that DIUC did not provide enough information for ORS to determine whether or not DIUC is the owner of those facilities. (October 28, 2015, Hearing Tr. p. 502 and p. 517).

In its Opinion No. 27729, the Supreme Court stated that on remand, when the Commission recalculates DIUC's rate base, it should take into account DIUC's ownership of the water tank, well, pipes, and other utility equipment located on the property sold at a tax sale in October 2010 to Mamdough Sabry Abdelrahman ("Elevated Tank Site").

In accordance with the guidance handed down by the Supreme Court, at the re-hearing ORS added the water tank, pipes, and other utility equipment located on the Elevated Tank Site into DIUC's rate base.

At the October 28, 2015 hearing, with respect to the overall rate base, the POAs recommended that DIUC's rate base as proposed \$7,085,475 be reduced by \$3,745,530 as a result of 1) increased accumulated depreciation, 2) contributions in aid of construction ("CIAC") and 3) CIAC amortization. (October 28, 2015, Hearing Tr. p. 371). Witness Loy for the POAs testified that Generally Accepted Accounting Principles ("GAAP") and appropriate regulatory accounting required that accumulated depreciation be calculated on a straight-line basis from the "in service" date through the end of the test year. (Id.) In addition, Mr. Loy testified that an adjustment increasing accumulated depreciation "reflects the proper age and condition of the utility property," (Id.) At the October 28, 2015 hearing, POAs witness Mr. Jue echoed Mr. Loy's conclusion, opining that the DIUC system "would be expected to reflect accumulated depreciation of approximately 30%." (October 28, 2015, Hearing Tr. p. 362). Mr. Loy also testified that certain DIUC plant purchased from Haig Point Utility Company ("HPUC") should be classified as CIAC rather than invested plant. According to Mr. Loy, International Paper (the original owner of

HPUC) and later Haig Point, Inc. (“HPI”) treated the utility plant in HPUC as inventory, expensed those costs, and donated those assets to HPUC. (October 28, 2015, Hearing Tr. p. 380). As support for this conclusion, Mr. Loy testified that HPUC Water Annual Reports for the years 2000-2003 showed no plant balances at all. (October 28, 2015, Hearing Tr. p. 381). The failure to classify plant as CIAC requires adjustments to both to net plant and CIAC amortization. Mr. Loy also testified that the appropriate characterization of DIUC plant as CIAC would greatly reduce the DIUC property tax burden, both for back taxes (a reduction of \$402,108 for tax years 2011-2013) and in the test year (a reduction of \$115,995 for tax year 2014). (October 28, 2015, Hearing Tr. p. 396).

In sum, at the October 28, 2015 hearing, the POAs recommended adjustments, largely to net utility plant, accumulated depreciation, contributions in aid of construction, and accumulated amortization to CIAC that would reduce the rate base for combined operations to \$3,276,311.

At the re-hearing, Witness Loy testified that DIUC’s proposed rate base is overstated due to an erroneous \$4.6 million accounting adjustment. (Rehearing Tr. p. 308, ll. 11-13). According to witness Loy, because a large portion of DIUC’s utility plant was donated, and thus DIUC had no original cost to pay for that plant, it was improper for DIUC to claim the cost of the utility plant to its balance sheet as paid in capital. (Rehearing Tr. p. 309, ll. 19-22, p. 310, ll. 1-2).

Additionally, Witness Loy testified that DIUC significantly overstated net plant by under recording accumulated depreciation. (Rehearing Tr. p. 308, ll. 17-18). According to witness Loy, the net plant values of DIUC are artificially high because plant representing excess capacity has not been depreciated according to NARUC guidelines, which require straight-line depreciation over the useful life of the plant in service. (Rehearing Tr. p. 308, ll. 17-20).

At the re-hearing, DIUC witness Guastella testified that the accounting methodology has been relied upon by DIUC and other parties in the past, and that in previous rate cases the balance sheets have been determined to accurately reflect the books and records. (Rehearing Tr. p. 102-103).

In contrast to the position taken by the POAs<sup>30</sup>, ORS carried forward the amount of rate base from the last rate case in Docket No. 2011-229-WS, \$4,615,755, and made adjustments through December 31, 2014<sup>31</sup>. (October 28, 2015, Hearing Tr. p. 524). Using DIUC's utilization factor method with ORS's adjustments, and taking into account the Supreme Court guidance, ORS recommended that \$1,134,068 be deducted from the Company's December 31, 2014 Application rate base. (Rehearing Tr. p. \_\_\_, ORS Audit Exhibit DFS-1, Re-Hearing Exhibit 8). Of the amount deducted, \$699,361 is gross plant in service representing non-allowable plant, adjustments from the previous case not carried forward by DIUC in this Application, and asset retirements. (Id.) ORS Audit Exhibit DFS-5 (re-hearing Exhibit 8) shows the specific items composing the \$699,361. (Rehearing Tr. p. \_\_\_, ORS Audit Exhibit DFS-5, Re-Hearing Exhibit 8). ORS also deducted \$180,067 from rate base for accumulated depreciation and deducted \$254,853 from rate base for Construction Work in Progress ("CWIP"). (Rehearing Tr. p. \_\_\_, ORS Audit Exhibit DFS-1, Re-Hearing Exhibit 8). Accumulated amortization of CIAC added \$213 to the rate base to arrive at a total net rate base deduction of \$1,134,068. (Id.) When \$87,676 in working capital was added to rate base, the total net rate base reduction became \$1,046,392. (Id.) After deducting the rate base adjustment from the Application Schedule W-B and S-B December 31, 2014, per books rate

---

<sup>30</sup> At the re-hearing, ORS testified that while it found the POA methodology to be reasonable, it chose to follow the same carryforward method it utilized at the October 28, 2015 hearing, and in past rate cases.

<sup>31</sup> For the carryforward amount, ORS used the rate base it calculated in the prior rate case instead of using the settlement agreement rate base in Docket No. 2011-229-WS.

base of \$6,914,024, ORS's recommended rate base for combined operations was \$5,867,632. (Id.) In summary, DIUC's recommended adjusted rate base was \$7,085,475, the POAs' was \$2,304,944, and ORS's was \$5,867,632.

The POAs arguments are compelling. However, given the number of rate cases that have occurred since International Paper owned the utility, the Commission declines to adopt a different rate base than the one carried forward from the last rate case by ORS. However, the Commission's conclusions regarding DIUC's rate base do not preclude the POAs or the ORS from taking a different position in future proceedings.

After reviewing the evidence presented by DIUC, ORS, and the POAs, the Commission accepts the rate base determination methodology and adjustments proposed by ORS. The ORS methodology accounts for the guidance given by the Supreme Court and is logical in its steps, follows the same procedure this Commission has approved in the past cases, and sets forth sound methods for determining a proper rate base on which a return may be granted.

#### Property Taxes

Since the last DIUC rate case in 2011, all parties agree that DIUC has property tax issues. DIUC did not pay 2009 and 2010 property taxes when due. As discussed above, DIUC's property was subject to a delinquent tax sale as a result. DIUC testified that Beaufort County mailed the tax bills to the wrong address. In addition, the Company's 2012, 2013, and 2014 Beaufort County property taxes were significantly higher than what they had been in years prior. At issue among the parties is how much property taxes should be paid by the ratepayers.

After learning about the delinquent taxes, DIUC and the Beaufort County Treasurer entered into a settlement agreement that was entered into evidence. The settlement agreement allowed DIUC to pay Beaufort County monthly payments of \$5,487.95 to cover property taxes totaling

\$526,843.39 for 2012, 2013, 2014, and 2015. The Beaufort County Treasurer testified that the monthly payment was derived by amortizing the \$526,843.39 over eight years. Originally the amount was \$651,267.27, but the settlement agreement was amended to the reduced amount of \$526,843.39 after the SC Department of Revenue (“DOR”) submitted lower asset values to Beaufort County.

With respect to its property tax request in this case, DIUC requested additional annual property tax expense of \$65,856 for the 2012, 2013, 2014 and 2015 taxes and \$ 188,093 for the annual amount of taxes going forward. DIUC’s property tax expense request totaled \$258,158 (\$4,209 per books plus \$65,856 plus \$188,093).

At the October 28, 2015 hearing, the POAs recommended that DIUC’s tax expense be based on the POAs’ downward-adjusted rate base. ORS testified that DIUC’s current books reflected approximately \$4,000 annually for property taxes and, with the ORS adjustments, DIUC would have \$171,492 annually to pay property taxes. Specifically, ORS recommended that DIUC receive \$30,612 annually for the 2012 and 2013 taxes totaling \$244,899 amortized over 8 years and \$140,880 for the 2014 or test year taxes. ORS based its 2012 and 2013 adjustment amount and amortization period on DIUC’s settlement with Beaufort County. The 2014 adjustment was based on the actual tax bills/assessment. ORS witness Gearheart testified that ORS allowed amounts for the 2012 and 2013 taxes, because DIUC did not have an opportunity to request a rate increase to pay the taxes after agreeing to a moratorium through July 1, 2014 in the settlement in Docket No. 2011-229-WS. ORS declined to allow property taxes for 2015 since ORS utilizes a historical test year.

In its Opinion No. 27729, the Supreme Court stated that an annual bill of \$65,856 is a substantial expense for which the Commission should have adjusted the test year data.

As a result of the guidance given by the Supreme Court, ORS computed an adjustment to amortization expense for property taxes of \$526,848 amortized over eight (8) years for an annual amortization of property taxes of \$65,856. (Rehearing Tr. p. 450, ll. 15-19). DIUC did not disagree with this approach taken by ORS and the resulting adjustment recommended by ORS. (Rehearing Tr. p. 450, ll. 18-19).

Additionally, based on guidance from the Supreme Court, ORS computed an adjustment to property taxes to reflect calendar year 2015 level. (Rehearing Tr. p. 451, ll. 1-5). Calendar year 2015 property taxes amounted to \$192,302 less the per book amount of \$4,210, for an adjustment to \$188,092. (Id.) DIUC agrees with this adjustment in its rehearing testimony and exhibits. (Rehearing Tr. p. 451, ll. 4-5).

Based on the evidence in the record and the guidance given by the Supreme Court, the Commission adopts the property tax amounts as computed by ORS as they are based on known and measurable amounts and incorporate the guidance given by the Supreme Court.

#### Management Fees and Other Expenses<sup>32</sup>

DIUC has a contract with GA for management services which was entered into evidence. (Hearing Exhibit 9.) In it, and confirmed through cross examination by the POAs and ORS, DIUC acknowledged that it agrees to pay GA a management fee of \$13,596.85 a month with an annual 3.5% increase; a finance fee of 2% of the principal amount of any loan or GA's actual total hourly rates for handling the loan, whichever is greater; a capital fee of 10% for the first \$50,000 of construction and 8% for construction costs over \$50,000; an incentive fee of 20% of the total net

---

<sup>32</sup> Management fees were not specifically mentioned in South Carolina Supreme Court Opinion No. 27729; however, in keeping with the Supreme Court's Opinion that this case be remanded to the Commission for *de novo* hearing, this issue was litigated at the re-hearing.

utility operating income; an incentive fee if DIUC is sold; rate case expenses; travel expenses; and expenses related to regulatory investigations and proceedings.

In its Application, DIUC requested that ratepayers pay \$171,364 for management services paid to GA. Per ORS, DIUC also included an incentive fee in its test year management fees. (October 28, 2015, Hearing Tr. p. 493). POA witness Lanier testified that the Commission should not allow DIUC to use its higher expenses related to GA to justify the need for a rate increase. ORS recommended that GA's management fees be limited to the previously Commission-approved amount of \$132,211 a year. ORS testified that it found no apparent increases in the management services provided by GA and did not find the requested increase justified. ORS also testified at the re-hearing that the management agreement lacks sufficient checks and balances to protect DIUC, its parent company, and its ratepayers from decisions made by its vendor, GA. (Rehearing Tr. p. 477, ll. 15-17). ORS testified that under GA's management, the Elevated Tank Site was sold to a third party after GA's failure to pay property taxes. (Rehearing Tr. p. 477, ll. 17-18). This oversight did not reflect a goal set by DIUC for GA which was to, "...operate the Company efficiently and manage its assets in order to minimize the rates charged to customers..." (Rehearing Tr. p. 477, ll. 18-20). Additionally, ORS presented evidence indicating that the management fees requested by DIUC are in excess of what other similarly situated investor owned water and wastewater utilities pay for similar services. (Rehearing Tr. p. 478, ll. 3-9).

At the re-hearing, DIUC witness Guastella testified that the GA Management Agreement contains a provision that allows the Client to terminate the agreement; therefore, sufficient checks and balances do exist. (Rehearing Tr. p. 95, ll. 18-22, p. 96, ll. 1-2). Additionally, DIUC witness Guastella testified that the utilities to which ORS compared DIUC are not similarly situated. (Rehearing Tr. p. 96, ll. 24-26, pp. 97, 98).



ORS excluded from operating and maintenance expenses the incentive fee<sup>33</sup> included in the test year and \$25,439<sup>34</sup> representing GA's management fee, legal expenses related to the property tax appeal and tax sale of the water tower, and other expenses not allowable for rate making purposes. DIUC witness Guastella disputed all exclusions noting "[GA's] efforts reflect an unequivocal commitment to provide adequate service to the customers, some of which were achieved because of GA's rate setting expertise that is not typical of other managers." "Having consulted for some 600 developer-related water and sewer utilities, I am not aware of any that had managers with the regulatory, utility accounting, valuation, or rate setting experience that GA applied in meeting the challenges of managing DIUC." DIUC witness Guastella also testified, contrary to ORS's testimony, that the existing and proposed rates do not include any allowance for GA's incentive fee.

Upon review of the evidence, the Commission adopts ORS's adjustments for management fees, rate case expenses, and non-allowable expenses. We agree that GA provides services to the ratepayers, but disagree that the services are at a level that warrant the amount set forth in the management services contract. Additionally, we believe that evidence was presented that calls into question the arms-length negotiations and transactions that occur between GA and DIUC. We think it is appropriate for DIUC stockholders to have responsibility for the difference. While customer service complaints are few in number, this Commission did hear testimony at the night hearing and the merits hearing that GA was an absentee management company and had very little presence on the island. It is undisputed that DIUC did not pay property taxes under GA's tenure (resulting in the tax sale described above), that required regulatory reports and fees have been filed

---

<sup>33</sup> See ORS Adjustment 4(m).

<sup>34</sup> See ORS Adjustment 4(g).

and paid late (R. p. 244), and that the South Carolina Department of Health and Environmental Control (“DHEC”) issued a notice of violations against DIUC (October 28, 2015, Hearing Tr. p. p. 319, ll. 14-16). We conclude the ORS-recommended amount for management expenses strikes a reasonable balance.

Rate Case Expenses<sup>35</sup>

At the re-hearing, DIUC requested \$794,210 for current and unamortized rate case expenses to be recovered over 3 years. (Rehearing Tr. p. 473, ll. 15-17). ORS proposed that rate case expenses total \$272,382 and be amortized over five years. (Rehearing Tr. p. 474, ll. 18-22, p. 476, ll. 21-22, p. 477, ll. 1-2). The \$272,382 consists of capped current rate case expenses in the amount of \$75,000 for GA’s preparation of the Application<sup>36</sup>, developing rate models, calculating test year data, filing other rate case documents and legal expenses. (Rehearing Tr. p. 450, ll. 8-14). ORS recommended \$75,000 as a reasonable amount for rate case expenses in the last rate case. Additionally, \$22,500 of the \$272,382 is unamortized rate case expenses from the previous rate case. The remaining amount is accounted for by legal services. (Id.)

At the re-hearing ORS testified regarding a number of adjustments to rate case expenses that were not contested by DIUC. (Rehearing Tr. p. 86, ll. 4-7). The one rate case expense adjustment DIUC did contest at the hearing was ORS’s adjustment of \$542,978, which corresponded to GA invoices. (Rehearing Tr. p. 476, l. 11). According to ORS witness Hipp, GA Invoices contained mathematical errors, lacked sufficient detail, and/or did not appear to be

---

<sup>35</sup> Rate Case expenses were not specifically mentioned in South Carolina Supreme Court Opinion No. 27729; however, in keeping with the Court’s Opinion, DIUC introduced new evidence that altered its original Rate Case expense request. As a result, this issue was litigated at the re-hearing.

<sup>36</sup> The \$75,000 is a figure that was used in the previous hearing and was arrived at during Settlement Negotiations between the ORS and POAs.

paid. (Rehearing Tr. p. 476, ll. 11-18). ORS witness Hipp testified that when reviewing invoices, ORS checks for mathematical accuracy, whether the invoice is for a valid business purpose, whether the expense was incurred during the period under review, whether the invoice was properly recorded on the books and records of the Company, and whether the invoice was paid. (Id.) ORS testified that generally the GA invoices failed this criteria, and also offered specific examples. (Rehearing Tr. p. 476, ll. 11-18, ORS DMH Surrebuttal Exhibit 1, Re-hearing Exhibit 10). During her testimony ORS witness Hipp specifically cited a number of examples of invoices that were insufficient for reasons varying from lack of detailed description of work performed to mathematical errors. (ORS DMH Surrebuttal Exhibit 1, Re-hearing Exhibit 10). Additionally, ORS witness Hipp attached an exhibit detailing the problems with each invoice for which ORS recommended an adjustment. (Id.) Furthermore, ORS witness Hipp testified that on August 24, 2015, ORS discussed certain GA invoice deficiencies. (Rehearing Tr. p. 486, l. 22, p. 487, ll. 1-3). Finally, ORS witness Hipp testified that it is not the role of ORS to properly support the rate case of a company seeking a rate increase, and it was DIUC that failed to provide additional support for the work performed by GA. (Rehearing Tr. p. 487, ll. 4-9).

DIUC's witness Guastella testified that DIUC is seeking \$794,201.17, plus the \$60,781.56 incurred for the bonds and associated letter of credit, for rate case expenses. (Rehearing Tr. p. 76, ll. 8-12). According to DIUC witness Guastella, no regulatory agency has every raised any questions about the amount of detail in GA's invoices. (Rehearing Tr. p. 87, ll. 16-17). Additionally, he testified that without any notice, ORS suddenly declared GA's invoicing insufficient. (Rehearing Tr. p. 88, ll. 9-10). DIUC witness Guastella also testified that delayed payments that create accounts payable does not mean that costs incurred are not allowable for rate setting purposes. (Rehearing Tr. p. 89, ll. 19-21).

At the re-hearing DIUC requested a 3 year amortization period for rate case expenses. (Rehearing Tr. p. 92, ll. 7-23). ORS affirmed its position that a 5 year amortization period is a reasonable balance between the shareholders and ratepayers for this proceeding. (Rehearing Tr. p. 476, ll. 21-22, p. 477, ll. 1-2). DIUC witness Guastella testified at the re-hearing that a 5 year amortization period would mean that actual rate case expenses would not be fully recovered until January 2023. (Rehearing Tr. p. 92, ll. 20-21). ORS witness Hipp testified that the rate case amortization period should begin on July 1, 2016, which is the same date that DIUC chose to implement higher rates under bond. (Rehearing Tr. p. 490, ll. 13-18).

The Commission agrees with ORS's judgment that a rate case expense total of \$272,382 is a reasonable amount for this rate case. The evidence shows that a large sum of what DIUC seeks corresponds to invoices that cannot be verified. It cannot be the responsibility of the regulating agency, nor this Commission, to arbitrarily determine a value for services where one cannot be independently verified. We also agree that the amortization period of five (5) years and the inclusion of unamortized rate case expenses from the last rate case are reasonable. The reasons set forth for excluding the non-allowable expenses is based on sound rate-making principals and those costs should not be passed to ratepayers.

#### Bad Debt Expense

In its Application, DIUC proposed bad debt expense associated with its proposed increase in revenues to equal \$30,852. Initially, ORS provided testimony proposing to adjust the bad debt expense upward to \$213,732. (October 28, 2015, Hearing Tr. p. 498). In the Settlement Agreement between the ORS and the POAs, and consistent with DIUC's request in its Application, ORS revised its adjustment to bad debt expense to utilize the methodology proposed by DIUC in its Application. (October 28, 2015, Hearing Tr. pp. 502-503). When discussing the bad debt

expense, the Supreme Court stated that the evidence in the record establishes DIUC's bad debt expense to exceed \$100,000. In compliance with the Supreme Court's guidance, ORS applied its calculated bad debt percentage of 9.82% to DIUC's re-hearing proposed increase to calculate an adjustment to bad debt expense of \$116,056, for a total bad debt expense of \$221,439. (Rehearing Tr. p. 453, ll. 16-20). Without expounding any further on the topic, DIUC witness Guastella stated that he disagreed with ORS adjustment to the bad debt expense. (Rehearing Tr. p. 84, l. 8).

The POA's witness Lanier testified that ORS's evaluation of bad debts at the re-hearing failed to fully analyze the Company's actual test year bad debt expense and failed to consider the prudence of the amount of \$105,667. (Rehearing Tr. p. 370, ll. 16-19). Therefore, witness Lanier proposes exactly what the Company included in its Application, 0.5% on water and sewer rate revenues and 2.5% on water and sewer availability revenues. (Rehearing Tr. p. 371, ll. 4-8).

We conclude the bad debt expense methodology performed by ORS, and the resultant bad debt percentage of 9.82% by which to adjust the bad debt expense, is just and reasonable and complies with guidance handed down by the Supreme Court.

#### Deferral of \$155,328

DIUC seeks to have \$155,328 deferred for future rate recognition. (Rehearing Tr. p. 80, ll. 8-12). ORS testified that it believes that to the extent DIUC has incurred recoverable rate case expenses, those expenses should be recovered in the case presently before the Commission. (Hipp Rehearing Revised. p. 9, ll. 1-10). DIUC testified that the \$155,328 is the amount in excess of the 108.9% increase DIUC originally requested in its Application, and its recovery is necessary to make DIUC whole and delay a portion of the rate increase to the customers. (Rehearing Tr. p. 101, ll. 13-15).

The Commission concludes that the expenses properly incurred should be recoverable in the present case, to the extent allowable. Therefore, the Commission does not believe that \$155,328 should be deferred to a future rate case.

#### Performance Bond

DIUC is currently providing the maximum amount required for its performance bond in the amount of \$350,000 for water and \$350,000 for sewer operations. Using the criteria set forth in 10 S.C. Code Ann. Regs. 103-512.3.1 and 103-712.3.1, ORS recommended that DIUC be required to continue the current performance bond amounts. DIUC and the POAs did not challenge the performance bond amounts. Accordingly and pursuant to S.C. Code Ann. § 58-5-720 and 10 S.C. Code Ann. Regs. 103-512.3 and 103-712.3, the Commission requires that DIUC maintain its performance bond in the amount of \$350,000 for water and \$350,000 for sewer operations.

#### Other Adjustments

The remaining ORS adjustments are accepted by this Commission without discussion. They either were not disputed by the parties or were caused by carrying out the effects of the adjustments adopted above.

### **III. FINDINGS OF FACT**

1. DIUC is a water and sewer utility providing water and sewer service in its assigned service area on Daufuskie Island, Beaufort County, South Carolina. The Commission is vested with authority to regulate rates of every public utility in this state and to ascertain and fix just and reasonable rates for service. S.C. Ann. §58-5-210, *et. seq.* DIUC's operations in South Carolina are subject to the jurisdiction of the Commission.

2. DIUC requested in its Application to increase revenues for combined operations by \$1,182,301, consisting of a water revenue increase of \$590,454, and a sewer revenue increase of \$591,847, based on the rate of return on rate base methodology utilizing an ROE of 10.5% and a 2014 historical test year. At the re-hearing, DIUC re-affirmed that it sought the Application's originally proposed revenue requirement of \$2,267,721.

3. The appropriate test year period for this proceeding, selected by the Company, is January 1, 2014 through December 31, 2014.

4. The Commission will use the return on rate base methodology in determining and fixing just and reasonable rates.

5. The return on rate base methodology requires three components: capital structure, cost of debt, and cost of equity (or return on equity).

6. The Commission adopts the capital structure of 46% long-term debt and 54% equity; a cost of debt rate of 5.29%; and ROE of 9.31%.

7. The Commission sets DIUC's rate base at \$5,867,632.

8. The Commission approved revenues and expenses establish a fair and reasonable operating margin of 15.22%. S.C. Code Ann. § 58-5-240(H).

9. The Management Agreement lacks characteristics required of an arms-length transaction and, therefore, should be carefully reviewed.

10. For certain rate case expenses, DIUC failed to provide invoices that could be verified; as a result, DIUC is ineligible for cost recovery of those expenses.

11. A five (5) year amortization period for rate case expenses is a reasonable balance between DIUC's shareholders and the ratepayers. Additionally, the amortization period began running on the date which DIUC first implemented its higher rates.

12. A bad debt percentage of 9.82% applied to DIUC's re-hearing proposed increase is a reasonable and appropriate manner of calculating DIUC's bad debts.

13. The deferral of \$155,328 is not appropriate where it could reasonably be recovered in the current rate case.

#### **IV. CONCLUSIONS OF LAW**

Based upon the Discussion, Findings of Fact as set forth herein, and the record of the instant proceeding, the Commission makes the following Conclusions of Law:

1. DIUC is a public utility as defined in S.C. Code Ann. § 58-5-10(3) and as such is subject to the jurisdiction of this Commission.

2. The appropriate test year on which to set rates for DIUC is the twelve month period ending December 31, 2014.

3. Based on the information provided by the parties, the Commission concludes the appropriate rate setting methodology to use as a guide in determining the lawfulness of DIUC's proposed rates and for the fixing of just and reasonable rates is return on rate base.

4. In order for DIUC to have the opportunity to earn the 9.31% ROE, found fair and reasonable herein, DIUC must be allowed additional revenues of \$864,817.

5. The Commission sets the amount to be recovered for management fees at \$132,211.

6. The Commission concludes that the appropriate amount to be recovered for rate case expenses at \$272,382.

7. The Commission concludes that the appropriate amortization period to recover rate case expenses is 5 years.

8. The Commission concludes that the appropriate bad debt expense adjustment is \$9.82% of the revenue requirement.



9. The Commission concludes that DIUC cannot defer the \$155,328 until the next rate case.

10. The rates as set forth in the attached Order Attachment No. 1 are approved for use by DIUC and are designed to be just and reasonable without undue discrimination and are also designed to meet the revenue requirements of DIUC.

11. Pursuant to S.C. Code Ann. § 58-5-720 and 10 S.C. Code Ann. Regs. 103-512.3 and 103-712.3, DIUC shall post a performance bond of \$350,000 water and \$350,000 for sewer operations.

12. Pursuant to S.C. Code Ann. § 58-5-240(D), “[a]ll increases in rates put into effect under the provisions of this section which are not approved and for which a refund is required shall bear interest at a rate of twelve percent annum. The interest shall commence on the date the disallowed increase is paid and continue until the date the refund is made. In all cases in which a refund is due, the Commission shall order a total refund of the difference between the amount collected under bond and the amount finally approved.”

IT IS THEREFORE ORDERED THAT:

1. The proposed rates, fees, and charges in Order Attachment 1 are both fair and reasonable and will allow DIUC to continue to provide its customers with adequate water and wastewater services.

2. Appeal costs in the amount of \$6,656.37 will be shared equally between ORS, Haig Point Club and Community Association, Inc., Bloody Point Property Owner’s Association, and Beach Field Properties, LLC and paid to DIUC.

3. The Company is to provide thirty (30) days' advance notice of the increase to customers of its water and wastewater services prior to the rates and schedules being put into effect for service rendered. The schedules shall be deemed to be filed with the Commission pursuant to S.C. Code Ann. § 58-5-240.

4. A return on equity of 9.31% and operating margin of 15.22%, based on the new rates, fees, and charges, is approved for DIUC.

5. The Company shall continue to maintain current performance bonds in the amounts of \$350,000 for water operations and \$350,000 for wastewater operations pursuant to S.C. Code Ann. § 58-5-720.

6. The Company shall implement all Commission approved adjustments on its books and records.

7. The Company's books and records shall be maintained according to the NARUC Uniform System of Accounts. The Company is directed to make any necessary adjustments to its accounting system to conform to the NARUC Uniform System of Accounts.

8. The Company shall refund the difference between the amount it collected under bond and the amount this Commission approves herein to the parties that paid the excessive rates at an interest rate of twelve percent annum. The interest commenced on the date the disallowed increase was paid and continues until the date the refund is made.

9. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

---

Swain E. Whitfield, Chairman

ATTEST:

---

Comer H. “Randy” Randall, Vice-Chairman